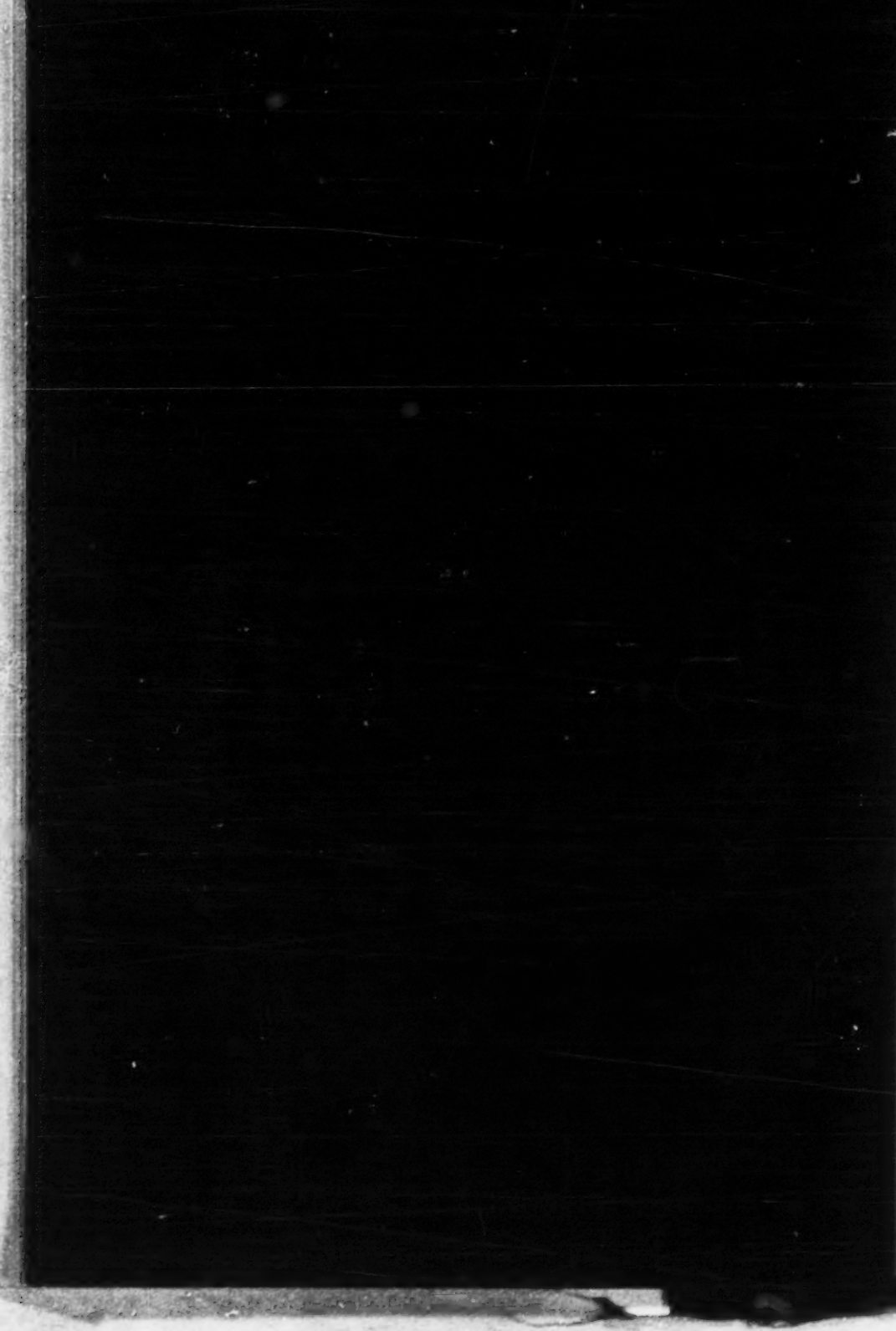




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**OF PETITIONS FOR WRITS OF HABEAS CORPUS IN THE UNITED STATES CIRCUIT COURT FOR THE DISTRICT OF COLUMBIA**

**FILED FOR THE COURT UNDER THE ACT OF MARCH 3, 1875**



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# In the Supreme Court of the United States

OCTOBER TERM, 1938

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No. 65

DOUGLAS FAIRBANKS, PETITIONER

v.

UNITED STATES OF AMERICA

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH  
CIRCUIT

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**BRIEF FOR THE UNITED STATES IN OPPOSITION**

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## OPINIONS BELOW

The opinion of the District Court (R. 51-55) is not officially reported. The opinion of the Circuit Court of Appeals (R. 132-138) is reported in 95 F. (2d) 794.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 2, 1938. (R. 139.) Petition for certiorari was filed May 28, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of

the Judicial Code as amended by the Act of February 13, 1925.

#### QUESTION PRESENTED

Whether the redemption and retirement in 1927, 1928, and 1929 of certain corporate bonds, pursuant to their terms, constitute the sale or exchange of a capital asset within the meaning of Sections 208 and 101 of the Revenue Acts of 1926 and 1928, respectively.

#### STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

\* \* \* \* \*

The provisions of Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, are substantially identical with the above.

#### STATEMENT

The pertinent facts, among others found by the District Court (R. 59-74), may be summarized as follows:

Petitioner owned several motion pictures upon which his cost basis was \$1,096,445.52. On March 5, 1925, he entered into a contract with the Elton Corporation, under which he transferred to that corporation his interest in the motion pictures in

exchange for \$4,000,000 par value of its bonds, to mature March 5, 1935, and 990 shares of its no-par-value stock. (R. 60.)

The bonds contained a provision permitting their redemption by the corporation at any time upon 30 days' notice to the registered holder thereof. Under the contract the Elton Corporation obligated itself to redeem \$100,000 face value of the bonds per year, beginning three years after the date of the contract. (R. 60.) The corporation did redeem, and petitioner surrendered for redemption, \$1,600,000 of such bonds in 1927; \$150,000 in 1928, and \$150,000 in 1929. (R. 60-61.)

Petitioner in his income tax returns for 1927 and 1928 reported the sums received from the redemption of the bonds. (R. 62, 63.) He took no deduction for cost, but reported the full amount received as taxable at the capital gain rate of  $12\frac{1}{2}$  percent. For the year 1929 petitioner reported the amount received from the redemption of the bonds at the capital gain rate of  $12\frac{1}{2}$  percent, but claimed a proportionate amount of a total cost basis, which was less than the amount later agreed upon as the total cost basis in a settlement for prior years. (R. 65-66.)

In December, 1929, petitioner and the Commissioner of Internal Revenue reached a settlement for the years 1917-1926, under which there was left to petitioner an unrecouped, unamortized cost of pictures of \$1,096,445.52. (R. 64.)



Petitioner filed claims for refund for the years 1927, 1928, and 1929, setting forth that he had not used the proper cost basis for the bonds redeemed. (R. 67-68.) The Commissioner on January 26, 1932, refunded to petitioner for the year 1927 \$53,231.55, together with interest in the sum of \$9,709.05; for the year 1928 \$7,507.38, with interest in the sum of \$932.40; for the year 1929 \$677.56, with interest in the sum of \$42.99. (R. 72-73.) Thereafter, the Commissioner of Internal Revenue determined that the refunds were erroneous,<sup>1</sup> and on July 6, 1933, officially demanded return to the Government of the sums refunded. (R. 73-74.) No part of the sums refunded has been returned. (R. 74.)

This action at law was instituted in the District Court on January 20, 1934 (R. 24), in accordance with Section 610 of the Revenue Act of 1928, to recover the sums of money erroneously refunded to the petitioner, together with interest thereon, at 6 percent per annum from the date of payment thereof. The refund was alleged to be erroneous because the amounts received from the Elton Corporation should have been taxed as income and not

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<sup>1</sup> In fact, application of both normal and surtax rates to the income shown in Findings XV (R. 62), XVII (R. 63) and XXIII (R. 65-66) discloses that in addition to the sums erroneously refunded, petitioner's tax had been underpaid: for 1927, by \$91,160.64, for 1928, by \$5,257.43, and for 1929, by \$7,322.10. However, because of the bar of the statute of limitations, these sums are not involved in this suit.

as capital gain. (R. 29, 35, 40). Jury was waived and the case was tried to the court, which held that the redemption of the bonds was not a "sale or exchange," and rendered judgment for the respondent in the sum of \$72,186.94, with interest at 7 percent per annum from the date of demand of the return of the erroneous refunds to the date of judgment. (R. 76-77.) On cross-appeals, the Circuit Court of Appeals affirmed, with the modification that interest was allowed on the erroneous refunds at 6 percent per annum from the date of the payment of the said refunds. (R. 139.)

#### ARGUMENT

The question is narrowed to whether or not the redemption of the bonds, pursuant to their terms, was a sale or exchange within the meaning of Section 208 (a) (1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, and Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791. These sections are substantially identical, providing:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

\* \* \* \* \*

While the Board of Tax Appeals first held to the contrary (*Werner v. Commissioner*, 15 B. T. A. 482), the lower tribunals are now in accord that "sale" or "exchange", as used in the above sections, should

be given their well-established meaning; and that the redemption of the bonds, pursuant to their terms, is not a sale or an exchange.<sup>2</sup> *Watson v. Commissioner*, 27 B. T. A. 463; *Braun v. Commissioner*, 29 B. T. A. 1161; *Rands v. Commissioner*, 34 B. T. A. 1107; *Brown v. Commissioner*, 36 B. T. A. 178; *Hale v. Helvering*, 85 F. (2d) 819 (App. D. C.); *Felin v. Kyle*, 22 F. Supp. 556 (E. D. Pa.); see, also, *Hellman v. Commissioner*, 33 B. T. A. 901.

These decisions are correct. The redemption and retirement of the bonds constituted neither a sale nor an exchange of capital assets, but payment, pursuant to call, of a fixed corporate obligation in accordance with its terms. The bonds on their face provided for their redemption at any time, at face value plus interest, upon notice to the registered holder thereof. (R. 60.) The corporation so redeemed, and thus extinguished its obligations.

None of the elements of a sale or exchange is present. There was no transfer of title; there was a mere payment of a debt, and return of the evidence of that debt. "Sale" and "exchange" connote a transfer of property to a new owner. Neither can be one-sided. There can be no sale without a purchase. There can be no exchange unless there be property parted with and property received by both parties. Certainly the corpora-

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<sup>2</sup> Compare *McKee v. Commissioner*, 35 B. T. A. 239, holding the gains taxable as capital gains when the bonds are sold to a third person shortly before the redemption sale.

tion received no property for the cash it paid. The bonds it had issued were mere evidence of its obligation. *Commissioner v. Great Western P. Co.*, 79 F. (2d) 94, 96 (C. C. A. 2d), affirmed, 297 U. S. 543. Upon payment of the obligation, in accordance with its terms, that evidence was returned to the corporation.

Furthermore, a change of the law was necessary to include sums received from the redemption of bonds in capital gain. *Felin v. Kyle*, *supra*. This change is found in Section 117 (f) of the Revenue Act of 1934,<sup>3</sup> c. 277, 48 Stat. 680, which provides:

SEC. 117. \* \* \*

(f) RETIREMENT OF BONDS, ETC.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

#### CONCLUSION

The decision below is correct. It is not in conflict with decisions of other courts. There are but few cases involving the question. The governing

<sup>3</sup>The committee reports do not explain why this change was made. H. Rept. No. 704, 73rd Cong., 2d Sess., p. 31; Sen. Rept. No. 558, 73rd Cong., 2d Sess., p. 11-13, 38.

statute has been changed. The petition should therefore be denied.

Respectfully submitted.

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✓  
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JULY, 1938.

